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U.S. RESTRUCTURING LEGISLATION: REVISING THE INTERNATIONAL BANKING ACT OF 1978, FOR THE WORSE?

CYNTHIA C. LICHTENSTEIN*

The Federal Deposit Insurance Corporation Improvement Act of 1991 contains several sections dealing with the regulation of foreign banks in the United States. In this Article, Professor Lichtenstein gives a critical analysis of the new foreign-bank legislation. After arguing that these legislative changes do not adequately address the emerging global financial marketplace, Professor Lichtenstein offers a modest proposal for revising the U.S. regulatory structure.

INTRODUCTION

THE 1989 financial reform legislation in the United States, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"),¹ in Section 1001 directed the Treasury Department to make a study of the United States federal deposit insurance system and to include the Treasury's suggestions for modernizing the United States regulatory structure for financial institutions.² The Treasury Study, "Modernizing the Financial System: Recommendations for Safer, More

* Professor of Law, Boston College Law School; Consultant, Milbank, Tweed, Hadley & McCloy, New York. This article is based on an address given by Professor Lichtenstein on December 5, 1991, as part of the Fordham University School of Law Graduate Colloquium 1991-1992, Transnational Financial Services in the 1990s. This article, moreover, was originally prepared by the author for a special Task Force of the New York State Bar Association's International Law and Practice Section's Committee on International Banking, Securities and Financial Transactions (Chairman: Elliot Gewirtz, Milbank, Tweed, Hadley & McCloy). The Task Force has since substantially reworked the article, and the article as presented here is not the collective product of the Task Force, but the author's responsibility. The author is grateful, however, to members of the Task Force for all their insightful comments.

Finally, the article was prepared while the bills that ultimately became the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), signed by the President on December 19, 1991, were proceeding through Congress. While the article has been updated where possible to refer to provisions contained in S. 543, as it emerged on November 27, 1991 from the House-Senate Conference, some of the discussion relates to provisions subsequently deleted from the limited bill ultimately passed by the Congress. Nevertheless, a critique of the problems contained in unadopted versions of the 1991 restructuring legislation remains valid since in signing S. 543, the President criticized the legislation as "narrow" and called for reconsideration of the Administration's proposals. In early February 1992, there was introduced into Congress the Financial Institutions Safety and Consumer Choice Act of 1992 whose provisions will also have to be carefully scanned for their effect on foreign bank entry.

The author is extremely grateful to Lynn Stofan Kaplan, Esq. for her detailed and insightful analysis of the legislation as passed. Any errors in description, however, are solely those of the author.

1. Financial Institutions Reform, Recovery, and Enforcement Act, Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified as amended at 12 U.S.C. §§ 1811-33 (Supp. II 1990)) [hereinafter FIRREA].

2. FIRREA, *supra* note 1, § 1001(a), 103 Stat. at 507.

Competitive Banks," was published in February, 1991.³ The recommendations in the Study included (1) broadening the powers of commercial banking organizations in the United States to include insurance and securities powers; (2) permitting nationwide branching by commercial banks as well as the possibility of national expansion through bank subsidiaries of a holding company; and, most controversially, (3) permitting the ownership of bank holding companies (called, with the expanded powers, "financial services holding companies") by commercial and industrial firms.⁴

The Study recommended a particular organizational structure for the expanded powers on the theory that spinning off the expanded permitted forms of business into separate companies would better enable functional supervision by a variety of regulators and would separate those subsidiaries taking insured deposits and having access to the payments system from other types of financial businesses and from the commercial and industrial investors in the financial services holding companies.⁵ The proposed structure for the modernization of the provision of financial services in the Study also called for the requirement that the new financial services holding companies maintain a higher level of capital than those holding companies with subsidiaries involved only in the kinds of business presently open to bank holding companies under the present regulatory legislation, the Bank Holding Company Act of 1956, as amended ("BHCA").⁶

However, while the Treasury Study bolstered its call for modernization of the structure of regulation of banks doing business in the United States with references to the competitive strengths of banking organizations subject to the regulation of other jurisdictions, the Study in its Discussion Chapter on Financial Services Modernization did not consider at all the integration into the modernization scheme of the present U.S. structure for federal regulation of the presence of foreign banking organizations in U.S. markets. Indeed, the Study reads as if its authors were unaware of the policy approach initially adopted in 1966 in the BHCA's coverage of entry by foreign banking organizations into the United States and more fully implemented—after over four years of consideration and six Congressional hearings—in the International Banking Act of 1978 ("IBA").⁷ This policy, so carefully worked, grants foreign banking orga-

3. See The Department of the Treasury, *Modernizing the Financial System: Recommendations for Safer, More Competitive Banks* (1991) [hereinafter *Treasury Study*].

4. See *id.* at xiii-xvii.

5. See *id.* at 67-69.

6. 12 U.S.C. §§ 1841-50 (1988).

7. See 12 U.S.C. §§ 3101-08 (1988). This policy was described by then-Comptroller of the Currency, John G. Heimann, in his testimony before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations on June 25, 1980 as being "to establish a federal regulatory framework which is *non-discriminatory* in its effects on domestic and foreign banks operating in this country and which affords foreign banks essential *equality of competitive opportunity* vis-a-vis domestic institutions in similar circumstances." *Hearings Before a Subcommittee of the*

nizations entering the U.S. markets *de facto* national treatment while insuring that differential regulatory treatment necessitated by inherent differences in the structure and operations of foreign banks does not unduly upset an equitable competitive balance between foreign bank entry and conduct of business in the United States and in our own domestic banks. Given the lack of discussion of this regulatory history in the Treasury Study, it was logical to assume that the policy would not be changed and that the actual legislation introduced into Congress to implement the Study recommendations would integrate the treatment of foreign banking organizations into the modernization scheme in a fashion sensitive to the delicate balancing of interests achieved by the IBA.

Instead, H.R. 1505, the Treasury's 1991 draft of legislation implementing the recommendations in the Study, contained a provision which would have subjected non-U.S. banks present in U.S. markets to a rigidly formalistic approach to "national treatment" by requiring a non-U.S. banking organization, as a condition of participation in the newly expanded financial services powers, to close down its branches and agencies and to establish a U.S. incorporated financial services holding company. A similar so-called "branch roll up" provision appeared in S. 543, the restructuring bill introduced into the Senate. While this particular provision was removed in Committee consideration of the bills, the bills that emerged from Committee continued to have provisions that detract from the original delicate balancing achieved in the IBA.

I. THE TREATMENT OF NON-U.S. BANKS AS THE BILLS EMERGED FROM COMMITTEE

Like the House bill that ultimately emerged from the House Committee on Banking—H.R. 6 (the Financial Institutions Safety and Consumer Choice Act of 1991 ("FISCCA"))—S. 543 as it was reported out by the Senate Committee on Banking, Housing and Urban Affairs on August 2, 1991, omitted the Treasury's branch roll-up and U.S.-incorporated holding company requirement. The Senate bill, however, contained a different type of roll-up provision: one that required any non-U.S. banking organization conducting an insured deposit-taking business to do so through a U.S.-incorporated bank.⁸ The legislative history of this provision, which was passed and codified as Section 214(a) of the Federal Deposit Insurance Corporation Improvement Act ("FDICIA")⁹ is explained fully by Senator Garn in a statement in the Congressional Rec-

House Committee on Government Operations, 96th Cong., 2d Sess. 276-77 (1980) (statement of John G. Heimann, Comptroller of the Currency) (emphasis in the original) [hereinafter *Hearings*].

8. See S. 543, 102d Cong., 1st Sess. § 214(a) (1991), available in Lexis, LEGIS Library, BL Text File.

9. This provision aroused considerable controversy, as a statement by the Federal Reserve Board on its interpretation of the provision indicated, and as of February 3, 1992, a proposal to "correct" the provision by a technical corrections bill is in Congress.

ord of December 18, 1991.¹⁰ The main thrust of Senator Garn's statement is the fundamental unwisdom of changing a structural requirement for non-U.S. bank business in the United States hastily and in the legislative heat of major legislation such as banking-reform legislation. Much of the controversy over Section 214(a) as enacted is caused by language in the provision that could be construed to require *any* foreign bank branch with deposit *balances* under \$100,000 (whether such balances are "retail" deposits or simply represent balances from commercial transactions) to roll up its branch into an insured subsidiary, thus possibly affecting a large number of foreign banks. The original intention, apparently, was only to require foreign banks benefitting from the new interstate banking provisions to be included in the reform legislation and to require that such banks actually engaged in a true retail banking business (a very small number of banks) incorporate their U.S. business in a U.S. bank.¹¹

Even a provision so limited, however, shows a lack of sensitivity to the concerns of those who wish to see the liberalization of the markets for financial services. Insured non-U.S. bank branches in the United States before FDICIA were subject to Federal Deposit Insurance Corporation ("FDIC") supervision as well as to regulation by the Office of the Comptroller of the Currency or by State authorities, but under FDICIA they are much more highly regulated. Despite the grater stability offered by such regulation, however, a number of non-U.S. banks, especially certain non-U.S. banks with large numbers of U.S. customers who are immigrants or descendents of recent immigrants from the countries in which the banks are based, are likely to find that such a requirement of U.S. incorporation lessens their appeal to their customer base. Excluding these banks' branches from the United States might invite the home countries of such banks to retaliate against the entry of U.S. bank branches into foreign locales. The concern of foreign authorities over such a shortsighted roll-up policy was expressed in a letter to Senator Riegle from Sir Leon Brittan, Vice-President of the Commission of European Communities, reprinted by Senator Garn in the Record.¹²

If a major issue of U.S. domestic policy were at stake, however, foreign concern perhaps could be overlooked. But the restructuring bills, both House and Senate, addressed in detail what might be such a domestic issue—the intensity of *federal* supervision over agencies and branches of non-U.S. banks.

Both S. 543 and H.R. 6 incorporated the provisions of bills introduced into the Senate and House (S. 1019 and H.R. 2432) to give the Federal Reserve considerably more supervisory authority over non-U.S. bank entry into the United States. These provisions, entitled the Foreign Bank Supervision Enhancement Act of 1991 ("FBSEA") and included in

10. See 137 Cong. Rec. 18,813 (1991) (statement of Sen. Garn).

11. See *id.*

12. See *id.* at 18,817.

FDICIA as enacted,¹³ amended the IBA to prohibit any non-U.S. bank from establishing a branch or agency in the United States without prior approval of the Board of Governors of the Federal Reserve System (the "Board" or the "Federal Reserve Board") and would specifically authorize (but not require) the Board in considering any application to take into account, *inter alia*, whether the non-U.S. bank engages directly in the business of banking outside the United States and "is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in [its] home country."¹⁴ The authorization of branches and agencies that are not so subject may be terminated.¹⁵ The criteria to be used in evaluating the U.S. operations of any such foreign bank are to be published within the year from December 19, 1991.

The Board also may consider the non-U.S. bank's financial and managerial resources (including its experience and capacity to engage in international banking) and whether the bank has provided the Board with adequate assurances that it will make available to the Board such information on its (or any affiliate's) operations that the Board deems necessary to enforce compliance with the BHCA and other applicable federal banking laws.¹⁶ It is noteworthy that the FBSEA was introduced in its original form (S. 1019) at the request of the Board. Thus, it may be surmised that, given the recent revelations concerning the activities of the Bank for Credit and Commerce International ("BCCI"), the Board was concerned with the need to ensure that, as the United States regulator most involved in supervision of the global activities of United States banks, it has the legal tools necessary to ensure that only adequately capitalized and properly supervised non-U.S. banking organizations are permitted to participate in the United States markets for financial services. Whatever the motivation behind the FBSEA, its enactment would certainly seem to obviate any claim that it is necessary to force any foreign bank taking insured deposits to incorporate as a domestic bank in order to ensure sufficient supervision for protection of the insurance fund. This is particularly true because as enacted, FBSEA limits the powers of state-licensed branches and agencies of foreign banks to those permissible for federal branches—branches licensed, under the IBA, by the Comptroller of the Currency and having only powers equivalent to those of national banks under the National Banks Act—unless, in the case of an insured branch, the FDIC has determined that the activity does not pose a risk to the deposit insurance fund.¹⁷

13. See 12 U.S.C.A. § 3101 (West 1992).

14. 12 U.S.C.A. § 3105(d)(2)(A) (West 1992).

15. See Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 202(a), 105 Stat. 2236, 2286-89 (to be codified at 12 U.S.C. § 3105(d)-(h)) [hereinafter FDICIA].

16. See FDICIA, *supra* note 15, § 202(a), 105 Stat. at 2287-88 (to be codified at 12 U.S.C. § 3105(e)).

17. See FDICIA, *supra* note 15, § 202(a), 105 Stat. at 2289 (to be codified at 12 U.S.C. § 3105(h)).

While both H.R. 6 and S. 543 as reported out of the respective Banking Committees included the Board's enhanced supervision proposals, and although neither acceded to the Treasury's call for a separately incorporated U.S. holding company if non-U.S. banking organizations were to be able to participate in the enhanced powers to be granted organizations in banking in the United States, H.R. 6 and S. 543 did include provisions affecting foreign banks and addressing their treatment of non-U.S. banking organizations in slightly different ways.¹⁸ Treasury's justification for the domestic holding company requirement was that such a requirement was the only way to ensure that the owner of both a banking subsidiary and a securities subsidiary would be adequately capitalized at the higher rate believed necessary to ensure that the presence of the combination of investment banking and commercial banking would not prove a detriment to the federal safety net.

As they emerged from the House and Senate Committees, each of the bills provided that the Board should disapprove any notice under Section 4 of the revised BHCA—the Section regulating the acquisition of non-banking business by bank holding companies—by any non-U.S. bank or company controlling a non-U.S. bank unless the Board determined that the financial resources, including the capital level, of such bank or company were, in the case of H.R. 6, “comparable to those of a domestic bank holding company that would be permitted to engage in such activities;”¹⁹ or, in the case of S. 543, “equivalent to those of a domestic bank holding company that would be permitted to engage in [such] activities.”²⁰ In the case of S. 543, the determination was to be made by the Board “after consultation with the Secretary of the Treasury regarding capital equivalency.”²¹ Under both bills, the Board, in making the determination, was to take into account differences in domestic and foreign accounting standards and was to assure that “competitive comparability between domestic and foreign banks is maintained.”²²

The Senate bill then went on to provide that if adherence to the equivalent capital required for a domestic bank holding company permitted to engage in securities activities could only be verified if banking activities were carried out in a domestic banking subsidiary, then the Board might require, as a condition of the approval of a notice under Section 4 of the BHCA, that the non-U.S. banking organization set up a single bank holding company and that all of the activities of the non-U.S. bank in the United States, other than those authorized under sections 2(h) or 4(c)(9) of the BHCA, be conducted by that new bank holding company

18. See S. 543, 102d Cong., 1st Sess. (1991), available in Lexis, LEGIS Library, BL Text File [hereinafter *Senate Bill*]; H.R. 6, 102d Cong., 1st Sess. (1991), available in Lexis, LEGIS Library, BL Text File [hereinafter *House Bill*].

19. *House Bill*, *supra* note 18, § 435(a)(3)(A).

20. *Senate Bill*, *supra* note 18, § 621(k)(2).

21. *Id.*

22. *House Bill*, *supra* note 18, § 441(a). S. 543 referred to the “competitive equivalence between domestic and foreign banks.” *Senate Bill*, *supra* note 18, § 621(c).

in its bank subsidiaries.²³ The Senate bill adopted a similar approach to approval of interstate branches of foreign banks.²⁴

Since these provisions of S. 543 would have left the determination of "verifiability" up to the Board and to the U.S. regulator that works most intensively with other central banks in the process of international banking regulatory coordination (often referred to as the Basle Supervisors Committee because of its meetings at the headquarters in Basle of the Bank for International Settlements), the provisions fall short of Treasury's original requirement that a domestic holding company be formed, and entry by branching denied, for those non-U.S. entities desiring to exercise in the United States the same enhanced powers as the restructuring bills would have given to domestic banking organizations.²⁵ Thus, S. 543 would have codified what in any event has been the Board's policy concerning the capital required of non-U.S. banking organizations for approval of applications to engage in nonbanking activities in the United States market or to acquire a U.S. bank.²⁶

Nevertheless, the Senate Banking Committee must not have been convinced of the Board's capacity (or, perhaps, reliability) to translate a non-U.S. regulator's risk-based capital requirements into U.S. requirements, for it added to S. 543 a provision that within 180 days after enactment of the bill, the Board and the Secretary of the Treasury (the "Secretary") together are to publish in the Federal Register and submit to both the House and Senate Banking Committees a report analyzing the Basle capital standards and the relationship of the Basle and non-U.S. standards to risk-based capital and leverage requirements for U.S. banks.²⁷ The two agencies then are to establish guidelines for the adjustments to be used by the Board in converting data on the capital of non-U.S. banks to the equivalent risk-based capital and leverage requirements for U.S. banks for purposes of determining "equivalency" where that is required for determinations under the legislation.²⁸

23. See *Senate Bill*, *supra* note 18, § 622(a).

24. See *id.*

25. S. 543 also had a number of other provisions aimed at insuring that non-U.S. banking organizations present or desiring to be present in the U.S. markets were not advantaged by being permitted by their own regulator to hold a lesser level of capital than their U.S.-owned counterparts, but it is not necessary for the purposes of this article to detail all of these other provisions. In each case, the determination as to the appropriate capital level was to be made by the Board after consultation with the Secretary of the Treasury, but once again the *formal* structure of entry was not dictated by the legislation.

26. See D. Holland, *Foreign Bank Capital and the United States Federal Reserve Board*, 20 Int'l Law. 785 (1986).

27. See *Senate Bill*, *supra* note 18, § 608.

28. This provision, for the study and the establishment of guidelines, has survived the legislative fray and, even though FDICIA does not contain any provisions giving securities or insurance powers to bank-holding companies or authorizing interstate banking, it does require the establishment of such guidelines to determine whether the foreign bank's capital is "equivalent" to that required of a U.S. bank in connection with applications to acquire banks and non-banking companies and to establish branches and agencies. The report and guidelines are to be updated annually and, of course, could be used by Treas-

Finally, S. 543 as it came out of Committee contained a section requiring the Secretary (together with the banking regulators provided for under the bill) and the Attorney General to conduct a study of "whether foreign banks should be required, as a general rule, to conduct banking operations in the United States through subsidiaries rather than branches."²⁹ The section required the study to take into account a variety of considerations, including "the difficulty of assuring that the foreign bank meets United States capital and management standards and is adequately supervised" and "safety and soundness considerations."³⁰ The mandatory list of study requirements did not include consideration of the implications for United States financial markets of burdening non-U.S. banks with such a limitation on the form of entry and the choices that non-U.S. banks might make if so burdened.

This provision also survived into FDICIA, although as enacted the study is to be carried out (and a report submitted to the House and Senate banking committees within one year of enactment) by the Secretary of the Treasury and the Board in consultation with the OCC, the FDIC, and the Attorney General. In addition to the two study topics listed above, the study is to take into account, *inter alia*, national treatment for foreign financial institutions; the need to prohibit money laundering and illegal payments; implications for international negotiations for liberalized trade in financial services; and whether the establishment of subsidiaries should be required only if U.S. banks are authorized to engage in securities activities and interstate banking and branching.³¹ In short, it would appear that both proponents and opponents had a hand in the "considerations" list. It may be suggested that in the past, when Congress wished a study of the conflicting interests at stake in proposed legislation, it held hearings and those who testified (or declined to testify) did so at their own expense in defense of their interests. Now, the study of the issues involved in changing so profoundly the facilitation of the entry of foreign financial institutions into our markets will be made at public expense by whatever "experts," inside or outside, the agencies choose to hire to write the report. One may ask whether these "experts" are disinterested, or, in the alternative, whether the new process has lost the former transparency of the speakers at Congressional Hearings.

II. THE POLICY ISSUES IN THE BILLS

Generally speaking, the restructuring legislative process, including the actual enactment of the limited FDICIA, has so far failed to take into account existing policy towards foreign bank entry or to consider and

ury as a means of threatening a protectionist policy in retaliation for a perceived failure of, say, the Japanese, to allow U.S. firms to expand in Japan. See FDICIA, *supra* note 15, § 214(b), 1505 Stat. at 2304 (to be codified at 12 U.S.C. § 3105).

29. *Senate Bill*, *supra* note 18, § 622(a).

30. *Id.* § 215.

31. See FDICIA, *supra* note 15, § 215, 105 Stat. at 2304-05.

adequately articulate the basis for a change in that policy. As indicated above, the author doubts that the study mandated by FDICIA will be very helpful in such articulation. It is the author's belief that the competitiveness of United States financial markets can only be enhanced by leaving up to each non-U.S. banking organization that the Board permits to enter or expand in the United States the choice of the most appropriate and profitable structure for entry. This is the present policy approach. Any concern for competitive equity between domestic and foreign institutions and for capital adequacy is sufficiently addressed by the new supervisory powers given to the Board in the Foreign Bank Supervision Enhancement Act provisions contained in FDICIA³² and by requiring the Board to use the guidelines on "equivalency" discussed above in considering foreign bank applications for acquisitions, branches, or agencies.

The Treasury "Modernization" Study considered at length the need to reform the structure of regulation of banking in the United States to permit U.S. banking organizations to be effective competitors in what are now thoroughly integrated global financial markets. The Study recognized, in effect, that the internationalization of the major industrialized countries' capital markets has taken place concurrently with—if not as a consequence of—the freeing up of financial services organizations to provide whatever financial services appear to be profitable within the prudential parameters set by the national supervisors, separately or in coordination under the Basle process. However, the Treasury's proposed legislation did not carry over these insights into its recommendations regarding foreign banks' presence in our markets.

Clearly, no one advocates eliminating prudential supervision over financial services companies; indeed, the aim of the international banking regulation process through the Basle Accord has been to work out a coordinated, nonduplicative, and comprehensive system of supervision over international financial services firms. It is indicative of the United States' commitment to this process that William Corrigan, President of the Federal Reserve Bank of New York, is now Chairman of the Basle Committee, and Richard Breeden, Chairman of the SEC, is presently Chairman of the International Organization of Securities Commissions' Technical Committee.³³ Even so, however, the more that the United States (consonant with its own basic concepts of banking regulation and the requirements of safety and soundness) can avoid restraints on competition

32. See *id.* §§ 201-15, 105 Stat. at 2286-305 (to be codified at various sections of 12 & 15 U.S.C.).

33. This committee is the securities supervisors' equivalent of the Basle Committee of bank regulators. For a description of its work, see generally C. Lichtenstein, *Introductory Note, Bank for International Settlements: Committee on Banking Regulations and Supervisory Practices' Consultative Paper on International Convergence of Capital Measurement and Capital Standards* [July 1988], 30 I.L.M. 967-78 (1991).

among its providers of financial services, the more U.S. capital markets will remain competitive in attracting foreign issuers and capital.

The author approves of the basic thrust of the 1991 Treasury bill, House bill, and Senate bill of increasing the capacity of banking organizations active in the U.S. markets to offer financial services of a wide variety, and regrets Congress' decision not to give the additional powers in FDICIA. Now in 1992, the original Treasury proposals are being re-introduced. This also is desirable, but as to non-U.S. financial services organizations, the effort should be to *reduce* barriers to entry. Requiring formal corporate structures increases such barriers. Instead, relative equality with domestic institutions should be enhanced through informational access and supervisory authority. This is consistent with the policy reflected in the IBA and its regulatory implementation. While such access and authority conceivably could need augmentation even beyond that provided by FBSEA (although the FBSEA appears stringent to the author), the basic policy of freedom of choice of *method* of entry—branch or subsidiary—by foreign banking organizations should not be changed.

A recent study by Hirtle, entitled "Factors Affecting the Competitiveness of Internationally Active Financial Institutions,"³⁴ has stressed that the presence in domestic markets of foreign firms has the effect of "providing innovative products and implementing sophisticated trading strategies originally developed in their home country markets."³⁵ The presence of outside firms increases the liquidity and depth of the markets in numerous ways. Chairman Greenspan also spoke of this point in his recent testimony before Congress.³⁶

If formal requirements for entry into a particular market by means of establishing an office raise the costs for an offshore entity relative to the gains foreseen from that mode of entry, the offshore organization will remain offshore and participate in that market only by offering its services peripherally. If the United States indulges in raising this kind of barrier, whether for formalistic or protectionist reasons, ultimately the result of the indulgence will be to drive the market for U.S.-dollar-denominated financial instruments and products offshore into markets that

34. See B. Hirtle, *Factors Affecting the Competitiveness of Internationally Active Financial Institutions*, 16 Fed. Reserve Bank N.Y. Q. Rev. 38 (Issue No. 1 Spring 1991).

35. *Id.* at 38.

36. Alan Greenspan, the Chairman of the Federal Reserve Board, stated:

The liquidity and depth of the U.S. banking environment has to a great extent been made possible by the participation of foreign banks. The active presence of foreign banks in this country has helped to assure the continued importance of the United States in international financial markets and has contributed to the growth of banking, including international banking, in a number of U.S. cities.

Hearings Before the House Committee on Banking, Finance and Urban Affairs, 102d Cong., 1st Sess. (June 11, 1991) (testimony of Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System). Similarly, the presence of U.S. banking organizations abroad enhances the competitiveness of capital markets abroad, as the United States regularly preaches to other nations.

permit the entrants to choose freely the corporate structure that best responds to the particular entity's own assessment of its needs.

Since FDICIA did not expand U.S. markets for financial services and so could not require of foreign banks a branch roll-up as the price of participating in that expansion, the immediate specter of damage to U.S. competitiveness is reduced.³⁷ The fact that Section 214(a) was around to be "misdrafted," however, means that the propensity for such harm has not entirely disappeared. Moreover, the Senate Committee appears to have been sufficiently struck by Treasury's concerns about the ability of the United States adequately to supervise and investigate non-U.S.-incorporated entities as to have inserted into S. 543 the authority for the Board to require incorporation of a U.S. holding company if the mandated capital level for the non-U.S. entity could not be "verified". This provision also did not make it into FDICIA, but even the considerations listed for FDICIA's Treasury study suggest a large degree of lingering suspicion. Thus, this time of reintroduction of the Treasury's proposed legislation is an appropriate one to reiterate why such structural requirements are not an appropriate method of balancing the interests at stake in revising the Federal scheme for regulation of non-U.S. participation in U.S. financial markets.

Furthermore, the discussion of U.S. interests in open markets gives the author an opportunity to urge a revision to the BHCA to grant to the Board a clearer mandate to authorize non-U.S. entities that include insurance services in their offerings to the global markets to continue their valued participation in U.S. markets despite their offshore acquisition of insurers having some U.S. presence.

III. THE INTEREST OF THE UNITED STATES IN A FEDERAL SCHEME OF ENTRY FOR NON-U.S. BANKING ORGANIZATIONS

A quotation from the former Comptroller of the Currency, John G. Heimann, referred to above,³⁸ well articulates the U.S. policy interest in a federal regulatory framework that is nondiscriminatory and that affords non-U.S. banks essential equality of competitive opportunity. While the Comptroller's testimony in 1980 did not detail the economic conception behind this policy, it is clearly in the interest of the United States to maintain the preeminence of its own financial markets by insuring the presence therein of the most efficient non-U.S. competitors. This presence is assured by the U.S. capacity to maintain the attractiveness to the strongest non-U.S. institutions of the U.S. markets for financial services. This attractiveness is ensured by the policy delineated by the Comptroller and enshrined in the IBA.

This attractiveness will be destroyed, however, if in an effort to ensure

37. As discussed above, Section 214(a) will be repaired by a technical corrections bill presently before Congress. See *supra* note 10 and accompanying text.

38. See *supra* note 7.

that non-U.S. organizations are not given an advantage in their U.S. operations vis-a-vis U.S. banking organizations, the U.S. regulatory scheme forces non-U.S. banking organizations to choose between complete replication of the limited powers, on the one hand, and business permitted to U.S. organizations containing a commercial bank and a U.S. presence, on the other. It is understandable that, since U.S. banking organizations compete in the global markets with banking organizations headquartered in other countries that have differing (if not less stringent) regulatory schemes, the United States believes that it has a policy interest in not allowing foreign enterprises to have what U.S. banking organizations might consider a competitive advantage by being permitted U.S. business impermissible to U.S. banking organizations. Clearly, in a world of different basic conceptions of what are appropriate kinds of businesses to be permitted in a financial services conglomerate, the policy dilemma will never have a neat, thorough solution.

The best possible resolution of the dilemma would in fact be achieved by implementation of the Treasury recommendations for modernization: ensuring the global competitiveness of U.S. banking organizations by doing away with the major U.S. regulatory restrictions on the combination of businesses. As of this writing, it is impossible to predict what Congress will ultimately accept as U.S. policy vis-a-vis the combination of banking and commerce or even the combination of domestic banking and insurance. Currently, U.S. banking organizations are permitted to invest in certain types of insurance business abroad—although the Board continues to limit the reach of such investment, apparently because of safety and soundness concerns with casualty-type insurance. It seems likely at this writing that in 1993—if not in 1992—Congress will enact restructuring legislation to do away with the Glass-Steagall barrier between investment banking and commercial banking, although, without doubt, both separate capitalization and a series of far-reaching firewalls will surround the banking entity in the new financial services conglomerates.³⁹

To the extent that barriers are removed, there would seem to be no policy objection to integrating off shore banking organizations into the structure. Thanks to the FBSEA, the Board now has more than sufficient power to ensure that any non-U.S. banking presence in the United States has, regardless of its utilization of expanded powers, the requisite financial strength and managerial integrity to guarantee that the non-U.S. participation in the payments system is backed by a parent able to serve as a source of strength to the U.S. banking presence.

To the extent that any future restructuring legislation requires additional capitalization for expanded powers for U.S. banking organizations, FDICIA's study and guidelines requirements will ensure that the Board demands the comparability of the capitalization of the non-U.S. entity

39. Since Japan is rapidly deconstructing its version of Glass-Steagall, if Congress does *not* act, the United States will be the last major industrialized nation so to hobble its financial services industry.

utilizing the expanded powers, *regardless* of whether the non-U.S. presence is established through a branch of the non-U.S. bank or through one or more separately incorporated domestic subsidiaries of the non-U.S. entity. It seems unlikely that the Board would ever experience such a problem with "verification" of non-U.S. entity capitalization that it would need to require a separate domestically-incorporated holding company to "verify" capital—particularly since such entities as a condition of entry must be subject to consolidated supervision. Even now, the Basle process is working on giving greater content to the concept of consolidated supervision, and this can only ease the Board's job in determining the capital soundness of foreign entrants. Treasury's concerns about adequate access to information are chimera.

IV. A MODEST PROPOSAL FOR LEGISLATIVE CHANGE

Since FDICIA does not break down the barriers for U.S. banking organizations between banking and commerce or between domestic banking and domestic insurance business, the United States once again is faced with the fundamental policy, issue vis-a-vis non-U.S. presence in the domestic financial services markets, that it faced and resolved first in the 1966 amendments to the BHCA and ultimately in the International Banking Act of 1978. Other countries do permit or appear likely soon to permit their commercial banks to be affiliated with insurance companies and/or industrial and commercial companies. At the same time, national economies are increasingly being integrated into a single global economy. For the United States to attempt to draw a bright line between non-U.S. banking organizations whose other forms of business are conducted exclusively abroad and those whose other kinds of businesses also extend into the United States means only that the great majority of the healthy innovative foreign competitors that the United States might wish to see present at home would be foreclosed from cost-effective entry. This is directly contrary to the goal of the IBA.

At the time the IBA was passed, Congress recognized that non-U.S. banks were permitted under home-country laws to hold investments in commercial companies. In one of the most important policy balances struck in the IBA, Congress adopted a scheme (embodied in Section 2(h) of the BHCA) under which foreign banking organizations principally engaged in banking abroad are permitted to have both a banking presence in the United States *and* to retain their holdings in commercial and industrial companies principally engaged in business outside the United States but doing business in the United States, so long as the U.S. business of the offshore non-banking company is in the same line of business.

The staff of the Federal Reserve has recognized that to a certain extent, the special Section 2(h) treatment is a deviation from "national

treatment" policy.⁴⁰ The Staff in a footnote to this statement pointed out that "[f]rom a somewhat different perspective, [Section] 2(h) may be viewed as being consistent with national treatment since its purpose is to neither encourage nor discourage foreign investment in the U.S. [sic] This is accomplished, however, by preferred treatment of foreign bank holding companies under the banking laws."⁴¹ With this rationale in mind, the Section 2(h) solution to the problem of foreign jurisdictions that have adopted a view of the necessity for separation of banking and commerce is fundamentally a reasonable and viable one.

Unfortunately, since the original Section 2(h) compromise was worked out in 1978, its application to non-U.S. banking organizations in *financial* businesses which would not be permissible to U.S. banking organizations has not received such a reasonable treatment. When the Board first proposed to Congress in 1977 the Section 2(h) treatment of foreign non-banking business, it also suggested that if non-U.S. banking organizations wanted to engage in the kinds of financial activities *permitted* to U.S. bank holding companies in the United States, they would have to do so on the same terms as U.S. bank holding companies—that is, as permitted under Section 4(c)(8) of the BHCA and Regulation Y. Given the direct competition in U.S. markets between U.S. and non-U.S. banking organizations, this provision also seemed reasonable, and Congress gave the Board the same discretion to examine the applications of foreign banking organizations seeking to enter U.S. financial business as it gave with respect to domestic bank holding companies.

Since the enactment of Section 2(h) in this form, however, Congress in subsequent banking legislation has cut back on the extent to which U.S. banking organizations may participate in the financial business of insurance. Moreover, at the time of the enactment of the Competitive Equality in Banking Act of 1987, Congress (at the last minute on the floor of the Senate) rewrote Section 2(h) by adding Section 2(h)(3), stating that nothing in the special authorization described above shall authorize a foreign bank holding company to "hold more than 5 percent of the outstanding shares of any class of voting securities of a company engaged in . . . banking, securities, insurance, or other financial activities . . . in the United States."⁴² The Board still retains its powers of special exemption under Section 4(c)(9) of the BHCA, but as that provision refers to "the public interest," the Board may not feel it proper to permit non-U.S. banking organizations to invest in or combine with non-U.S. insurance companies doing the kind of insurance business in the United States that it has not permitted U.S. banking organizations to invest in abroad—not

40. See Federal Reserve Staff Memorandum to the Board (April 25, 1980), *reprinted in Hearings*, *supra* note 7, at 748, 756.

41. *Id.* at 756 n.6.

42. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 205(a), 101 Stat. 552, 584-85 (codified as amended at 12 U.S.C. § 1841(h)(3) (1988)).

so much because of the Board's conception of policy, but because of its proper concern for deference to the will of Congress.

Similarly, in promulgating regulations implementing section 2(h), the Board has taken a very narrow view of the meaning of "principally engaged" in the banking business abroad, so as to define just which non-U.S. banking organizations qualify for the Section 2(h) exemption of their U.S. non-banking business. The Board has insisted all along that the reason for restricting the Section 2(h) exemption to non-U.S. entities primarily engaged in the banking business is to ensure that the entrants into the U.S. banking markets are those entities that are supervised by foreign central banks with whom the Board cooperates in the coordination of international banking regulation at the Bank for International Settlements or other banking supervisors offering substantial consolidated supervision. However, in its regulation defining what is meant by the "banking business" for the purposes of Section 2(h), the Board in the past has considered in only the non-U.S. entity's banking business that would be regarded as "banking" under U.S. conceptions, and has not been willing, until the most recent revision of Regulation K, to include any insurance business. Moreover, its regulation has insisted that the business that is counted for the purpose of determining whether or not the entity is "principally engaged in the banking business" be in the same corporate line as the non-U.S. bank—thus, in effect, confusing the concern for safety, soundness, and adequate supervision of the foreign entrant with the concern evidenced by Congress that foreign banks not be able to enter in the U.S. insurance business. The Board in its recent revision of Regulation K has struggled with these issues, but while the situation has been ameliorated, it has hardly been resolved.

At the present time in the European Community, the banking business and the insurance business are engaged in considerable consolidation.⁴³ For example, in the United Kingdom, Lloyds Bank Plc has purchased a controlling interest in a major insurer, Abbey Life Group Plc.⁴⁴ In France, banks now earn thirty percent of the premium income in the French life insurance market.⁴⁵

In the interest of competitive equality, it is understandable that if a U.S. banking organization may not purchase or be purchased by a U.S. insurance company, then a non-U.S. banking organization doing a banking business in the United States in competition with U.S. banking organizations should be similarly restricted. There is no reason, however, why this prohibition should force non-U.S. banking organizations pres-

43. For an extensive list of recent affiliations between banks and insurers in the EC, see the paper prepared by the Institute of International Bankers, February 1990, "Impact of U.S. Regulation on Banks and Insurance Affiliations Taking Place In Europe In Connection With the Formation of a Single Market in 1992."

44. T. Kamm, *European Banks, Insurance Firms Search for Synergies*, Wall St. J., Apr. 26, 1989, at A12, col. 1.

45. *Bankassurance Afresh*, World Ins. Report, July 7, 1989.

ent in the United States to choose between their U.S. banking presence and the acquisition of or by a foreign insurance company principally engaged in business abroad but, in an integrated global economy, with U.S. business. The fact that a merger partner of a non-U.S. banking organization has U.S. insurance business should not be allowed to deny the United States the benefit of the competitive presence in its financial markets of the non-U.S. banking organization.

In 1978, Congress accepted that in order to keep the beneficial presence of non-U.S. banking organizations in the United States, it would authorize such organizations to have commercial and industrial holdings with a U.S. presence so long as those holdings were themselves principally engaged in business abroad. Presently, at a time when Congress is once again considering restructuring proposals and the place therein of the presence of non-U.S. banking organizations in the U.S. markets, Congress should revise Section 2(h) so as to indicate to the Board its willingness to allow the presence of non-U.S. entities that are under consolidated supervision and that are comparably capitalized (in the Board's judgment), and that are also engaged in the U.S. in financial businesses not permissible to U.S. banking organizations—so long as those businesses are principally conducted in abroad and so long as the U.S. business is not the principal source of revenue of that type for the foreign organization. This would extend to the offshore insurance business of the non-U.S. banking entrants addressed by the compromise reached in Section 2(h) with respect to non-financial businesses. It would preserve for the United States the beneficial presence of the strong entities in the strong financial conglomerates now being formed in Europe. The author urges this solution to one of the myriad difficult problems of competitive equality and national treatment.